TENNESSEE DEPARTMENT OF FINANCIAL INSTITUTIONS

Report on the Title Pledge Industry
A supplement to the 2006 Report to the Tennessee General Assembly

February 12, 2007

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Introduction

Significant amendments to the Tennessee Title Pledge Act ("Act"), Tenn. Code Ann. § 45-15-101, et. seq. took effect November 1, 2005. Most importantly, the amendments subjected the title pledge industry to licensing and examination by the Department of Financial Institutions ("Department"). Pursuant to an amendment to § 45-15-108(e) of the Act, the Department was required to submit to the general assembly, no later than February 1, 2006, a written report, including at a minimum an analysis of the rates and terms of title pledge loans and the reasonableness and appropriateness of the rates and terms. On February, 1, 2006, the Department submitted the report to the general assembly. The report, however, was based upon practices and financial data concerning the title pledge industry as the industry existed prior to the November 1, 2005, amendments to the Act.

The Department has now been licensing and conducting full compliance examinations of the title pledge industry for over a year. Moreover, for the specific purpose of assessing the financial condition of this industry after the implementation of the November 1, 2005 amendments to the Act, the Department has collected financial and operational information from the industry. The Department, therefore, submits this report as a supplement to the February 1, 2006 report. This report contains information regarding the current status of licensing and examination of the title pledge industry as well as analyses of the financial and operational information submitted by the industry to the Department.

Highlights of Amendments to the Tennessee Title Pledge Act

Amendments to the Act **effective November 1, 2005** include:

- Requires all title pledge lenders to submit to the Department a completed application with required supporting documentation along with a license fee in an amount prescribed by the Commissioner by rule, but not to exceed $800.00, per location. Note: Rule 0180-33-.01 established the annual license fee at $700.00.
- Requires applicants to provide financial statements, prepared by a certified public accountant not affiliated with the applicant, showing a tangible net worth of not less than $75,000 for each location.
- Requires applicants to submit a $25,000 bond or letter of credit per location, capped at $200,000 for a single title pledge lender.
- Requires borrowers to pay a principal reduction of 5% of the original principal amount of the title pledge agreement beginning with the third renewal. Requires that lenders calculate interest and fees at each successive renewal on the outstanding principal balance. Allows the lender to defer any principal reduction payment until the end of the title pledge agreement.
- Provides borrowers with a one day right to cancel the title pledge agreement.
- Requires that the sale of repossessed pledged property be made in a "commercially reasonable" manner as defined by the Uniform Commercial Code, and that any surplus from the sale be remitted to the borrower.
- Authorizes the Commissioner to charge the reasonable and actual expenses for examination of licensees.
- Grants the Commissioner subpoena power and the right to assess civil money penalties, issue cease and desist orders and require refunds to consumers.

- Grants the Commissioner the authority to suspend or revoke a license or suspend or bar individuals from the industry for violations of the Act.

2006 Regulatory Overview

Licensing

Upon close of the 2005 legislative session, the Department began the process of gathering information about the title pledge industry. The information-gathering process took place between July 1, 2005 and October 31, 2005. With respect to licensing, the following held true at the time:

- Title pledge lenders received a license from their respective county clerk
- The cost of the license was $50.00
- The offices of the county clerks reported that there were 931 title pledge business locations on record

Between July 1, 2005 and December 31, 2006, the number of title pledge lenders operating in Tennessee decreased. Of the 931 title pledge business locations identified by the county clerks, thirty seven (37) reported to the Department that they either had gone out of business or intended to do so due to the additional requirements of the amendments to the Act. During the information-gathering process, the Department collected and compiled information from 894 title pledge business locations. Due to a combination of additional closings and consolidation of offices, 610 of the 894 title pledge business locations made application for a license with the Department by December 31, 2005. There were additional locations that missed the filing deadline of December 31, 2005, but subsequently did make application for a license.

Prior to the November 1, 2005 effective date of Department regulation, 190 title pledge business locations were found to be charging interest and fees in excess of that allowed by law or collecting unauthorized charges such as late payment fees, returned check charges, additional interest, lien recording fees, loan application fees, loan renewal fees, and trip charges/storage fees associated with repossession of vehicles. Of these 190 locations, 157 became licensed with the Department, thirty (30) discontinued the business of title pledge lending, two (2) were denied a license, and one (1) withdrew the license application. On-site examinations conducted in 2006 have indicated that the practice of overcharging has been substantially stopped.

At calendar year end 2006, 703 title pledge locations were licensed with the Department. See attached additional information for a breakdown of title pledge lenders by county and city.

Examinations

For calendar year ending December 31, 2006, 663 on-site examinations were conducted on title pledge lender locations throughout the state. Based upon the number of title pledge lenders licensed at calendar year-end, this equals an examination penetration rate of 94%. Of the title pledge lenders examined, approximately 74% of the licensed locations had violations ranging from minor technical or recordkeeping to violations which resulted in refunds to consumers. The majority of violations were cleared through the examination function in follow-up with the licensee. It should be noted that licensees are required to provide the Department a written response to examinations and to document the manner in which violations are corrected. Some of the more prevalent violations cited in the examinations are as follows:

1) The Lender did not have evidence of renewals in writing in accordance with Tenn. Code Ann. § 45-15-113 (b).
2) The Lender failed to keep complete records of loan transactions in accordance with Tenn. Code Ann. § 45-15-110. *et seq*.
3) Loan agreements were greater than (30) days in length contrary to the requirements of Tenn. Code Ann. § 45-15-113 (a).
4) The Lender failed to provide correct federal Truth in Lending disclosures to all borrowers in accordance with Tenn. Code Ann. § 45-15-111(c) and Department Rule 0180-27-.04(2).

Continued regulatory oversight has addressed violations identified during the information-gathering stage and subsequently in compliance examinations. As previously noted, the practice of overcharging on rates and fees which was prevalent before regulation has been substantially stopped. Additionally, as of December 31, 2006, examinations of licensees resulted in refunds to consumers totaling $163,998 with an additional $98,245 in process of being refunded at the time of this report.

<u>Principal Reduction Requirement</u>

Pursuant to Tenn. Code Ann. § 45-15-113(d), the borrower is required to make a 5% principal reduction beginning with the third renewal of the title pledge agreement and the title pledge lender is required to reduce the outstanding principal balance subject to interest and fees by 5% per month whether the payment is received or not. This provision will likely decrease both the term of the title pledge agreement and the interest and fees received over the life of the title pledge agreement.

The principal reduction requirement became effective for the first time in February 2006. As such, the provision was not in effect long enough to show the overall impact on profitability for the reporting period. The following table illustrates long-term savings to the customer from the principal reduction requirement and the corresponding decrease in interest and fees received by the title pledge lender:

	22% Interest/Fees, No Principal Reduction *Under prior law*	**22% Interest/Fees, 5% Principal Reduction** *Current law*	**22% Interest/Fees, 10% Principal Reduction** *Example of impact of increase to 10%*
Original Principal Balance	$500.00	$500.00	$500.00
Payoff time	Perpetual	22 months	12 months
Total interest/ fees paid	Unlimited	$1,375.00	$825.00

Consumer Complaints

Tenn. Code Ann. § 45-15-118(c)(1) provides that any person aggrieved by the conduct of a title pledge lender, in connection with the title pledge lender's regulated activities, may file a written complaint with the commissioner who may investigate the complaint. Upon receipt by the Department, the complaint is forwarded to the lender for a response to the allegation(s). The lender is required to provide a written response to the complaint to both the Department and the consumer. In some cases, the allegation(s) in the complaint may result in an on-site examination of the lender to investigate the allegation(s) and address any potential violations of law.

For calendar year ending December 31, 2006, the Department received twenty-one (21) consumer complaints against title pledge lenders. Of these twenty-one (21) complaints, seventeen (17) have been resolved and closed, three (3) resulted in examinations and findings were pending at the time of this report, and one (1) was received late in the year and, at the time of this report, was under review.

From these twenty-one (21) complaints, the most frequent allegation involved the twenty day holding period, during which the borrower has the right to redeem their repossessed vehicle, as set forth in Tenn. Code Ann. § 45-15-114. The documentation received, including the complaint, the lender’s response, as well as the Department’s own investigation, revealed that none of the lenders against which this allegation was made violated this statute.

Five (5) consumer complaints alleged that the rates and fees charged were “excessive”. In all instances, investigation revealed that the lender was charging the rates and fees permitted by law. The investigation of these complaints revealed that they were directly related to the five percent (5%) principal reduction payment required by Tenn. Code Ann. § 45-15-113(d). In these instances, consumers indicated that the statutory requirement to make the principal reduction payment, in addition to interest and fees equivalent to 22% per month, was burdensome.

Two complaints involved disputes about the accuracy of the consumer’s account balance as recorded by the lender. In one case, the title pledge lender agreed to reduce the rate and fees to zero percent (0%) in order to allow the consumer to liquidate the account. In the second case, the lender offered the consumer a settlement amount that resulted in a savings of $59.

Financial Report Information

The operational and financial data which follows is derived from information provided by the industry. In September 2006, title pledge lenders began renewing their licenses. Tenn. Code Ann. § 45-15-106(i) provides that the license shall expire on October 31st of each year and that a license may be renewed upon application to the commissioner on or before October 1 of each year. A license renewal application packet was sent to all licensees in August 2006. The renewal application included a supplemental financial report designed to gather information for the time period of November 1, 2005 (effective date of licensing) to June 30, 2006, for the purposes of assessing the financial condition of the title pledge industry. Because it represents a customary fiscal year end, and to allow licensees time to compile financial data for submission with their renewals, the June 30 date represented an appropriate cut off.

This report requested information on an unconsolidated basis, which meant that companies engaging in more than one line of business were asked to segment their operational and financial data and report such data exclusively for the title pledge business. The supplemental report was to be prepared by a certified public accountant, signed by the licensee and notarized attesting to its truthfulness and accuracy. The following presents the operational and financial results of the supplemental financial reports filed with the Department.

Analysis of Operations

Data gathered and compiled by the Department was based upon supplemental reports submitted by 206 companies, representing 645 title pledge licensed locations. Results indicate that a total of 92,489 title pledge agreements were made as of June 30, 2006, with outstanding accounts receivable of approximately $40 million.

The following table presents a breakdown of title pledge agreements by loan amount:

Number of Agreements by Loan Amount:	
$250 or Less	26,178
$251 - $500	39,293
$501 - $1000	18,506
$1001 - $1500	4,832
$1501 - $2000	1,908
$2001 - $2500	1,772
Total Number of Agreements	92,489

During the reporting period, 196 companies representing 377 licensed locations (59%) entered into between one and one thousand (1,000) title pledge agreements. Eight (8) companies representing 176 licensed locations (27%) entered into 1,000-10,000 title pledge agreements. Two (2) companies representing 92 licensed locations (14%) entered into over 10,000 title pledge agreements. As illustrated in the preceding chart, approximately 70% of the agreements made were for $500 or less.

Title pledge lenders charged-off approximately $5.1 million due to non-payment of all or part of the original principal balance. This charge-off amount represents approximately 10.5% of the total dollar amount of loans made which was $48,524,130.

The industry reported that 10,933 vehicles were repossessed during this same period due to non-payment. Beginning November 1, 2005, the amendments to the Act required title pledge lenders to return any surplus from the sale of repossessed vehicles to the consumer. The title pledge industry returned a total of $171,579 in surplus from the sale of repossessed vehicles to consumers.

Analysis of Profitability

In analyzing the profitability of the title pledge industry, this report will consider net income, calculate financial ratios, and perform a breakeven analysis of interest and fees charged. One of the key factors used in this analysis is net income which constitutes a company's income from operations less the expenses for operating the business. In the title pledge industry, the income factor is made up of customary interest and fees. The expense factor includes, but is not limited to, advertising, salaries, rent, utilities, insurance, licensing, repossessions and charge offs.

The title pledge industry is comprised of various business structures including corporations, limited liability companies, partnerships and sole proprietorships. Although the administrative and operational expenses generally run consistent from one business structure to another, income tax may differ because the tax treatment associated with each type of entity varies significantly. This renders net income after tax less comparable between entities than income before tax. Therefore, net income referred to in this report is net income before tax. The combined net income for the 206 companies (645 licensed locations) reporting was approximately $17.8 million.

The following table provides more detail on net income in the title pledge industry:

Net Income	Number of Companies	Number of Reporting Licensed Locations
$1,000,000 or more	3	133
$100,000 - $999,999	36	162
$0 - $99,999	123	218
Negative Net Income	44	132

Of the 206 companies reporting (645 licensed locations), forty-four (44) companies, (132 licensed locations) reported a negative net income, which means they did not make a profit during the reporting period. In addition, another 123 companies (218 licensed locations) reported net income of between zero dollars and $99,999. The results indicate that, even for the title pledge lenders that reported a positive net income, there was a wide disparity in the level of profitability reported. For example, of the 123 companies (218 licensed locations) that reported net income of between zero and $99,999, the average net income was $27,216, which means that most of the companies fell toward the low end of the range. Similarly, of the 36 companies (162 licensed locations) that reported net income of between $100,000 and $999,999, the average net income was $229,195. Finally, for the three companies (133 licensed locations) that reported net income of $1,000,000 or more, the average net income was $2,475.341.

Financial ratios are another method of analyzing profitability by comparing a company's net income to the investment of capital (contributions from the owners) or comparing a company's net income to the assets of the business. The commonly used financial ratios that illustrate these comparisons are Return on Equity (ROE) and Return on Assets (ROA).

The following table describes the ratios and reports the results for the industry:

PROFITABILTY RATIO ANALYSIS		
Ratio	**Return on Equity**	**Return on Assets**
Formula	Net Income[(1)] / Net Worth[(2)]	Net Income[(1)] / Total Assets[(2)(3)]
Function	Measures ability to realize return on capital invested by owners.	Measures ability to realize return on assets.
Title Pledge Average	**16.47%**	**12.94%**

1) The title pledge industry is comprised of various business structures and the tax treatment associated with each type varies significantly. Therefore, net income before tax is a more comparable figure and is referred to in the above calculations and throughout this report.
2) Balance sheet information is presented on a consolidated basis in accordance with Generally Accepted Accounting Principles (GAAP).
3) Industry-wide, title pledge accounts receivable account for almost one-third of total assets.

To gain a better understanding of the industry, we have further categorized licensed locations within the industry by size and then applied the ROE and ROA ratios. As such, the data and analysis that follows will group the 645 title pledge licensed locations into one of four categories based on "like size" as indicated in the chart below:

Company Size	Number of Licensed Locations	Percent of Reporting Licensed Locations
Single location (1 location)	141	22%
Small (2-9 licensed locations)	195	30%
Medium (10-24 licensed locations)	123	19%
Large (25 or more licensed locations)	186	29%

Single Location Title Pledge Lenders

Title pledge lenders categorized as "single location" are companies that have only one licensed location. There are 141 companies (141 licensed locations) in this category, which represents twenty-two percent (22%) of the reporting licensed locations. This category entered into 20,341 title pledge agreements representing 22% of the total agreements made by the industry. Approximately seventy-eight percent (78%) of these agreements were for $500 or less. In regards to interest and fees, the majority of this category charges the maximum 22% allowed by law. However, there were five companies in this category that charged between 15% and 20%. The total net income for this category was $4,153,615 which represents twenty-three percent (23%) of the industry total. Of the 141 companies (141 licensed locations) in this category, thirty (30) companies or 21% reported a negative net income. This category charged-off 2,916 title pledge agreements, representing 29% of the total number charged-off by the industry, with a dollar value of $975,652. This category repossessed 2,641 vehicles, which represents 24% of industry total repossessions, with related expenses of $408,547. The average ROE and ROA for this category was 14.27% and 11.12%, respectively.

Small Title Pledge Lenders

Title pledge lenders categorized as "small" are companies that have between two and nine licensed locations. There are fifty-four (54) companies (195 licensed locations) in this category, which represents thirty percent (30%) of the reporting licensed locations. This category entered into 18,353 title pledge agreements representing 20% of the total agreements made by the industry. Approximately seventy-one percent (71%) of these agreements were for $500 or less. In regards to interest and fees, the majority of this category charges the maximum 22% allowed by law; however, two companies charged between 10%-22%. The total net income for this category was $4,382,440 which represents twenty-five percent (25%) of the industry total. Of the fifty-four (54) companies (195 licensed locations) in this category, twelve (12) companies or 22% reported a negative net income. This category charged-off 2,887 title pledge agreements, representing 28% of the total number charged-off by the industry, with a dollar value of $1,328,162. This category repossessed 1,970 vehicles, which represents 18% of industry total repossessions, with related expenses of $735,837. The average ROE and ROA for this category was 13.24% and 10.78%, respectively.

Medium Title Pledge Lenders

Title pledge lenders categorized as "medium" are companies that have between ten and 24 licensed locations. There are eight (8) companies (123 licensed locations) in this category, which represents nineteen percent (19%) of the reporting licensed locations. This category entered into 15,838 title pledge agreements representing 17% of the total agreements made by the industry. Approximately sixty-five percent (65%) of these agreements were for $500 or less. In regards to interest and fees, the majority of this category charges the maximum 22% allowed by law. There was one (1) company in this size category that charged between 20% and 22% for title pledge agreements. The total net income for this category was $6,584,897 which represents thirty-seven percent (37%) of the industry total. Of the eight (8) companies (123 licensed locations) in this category, one (1) company (or 12.5%) reported a negative net income. This category charged-off 2,341 title pledge agreements, representing 23% of the total charged-off by the industry, with a dollar value of $1,504,551. This category repossessed 1,793 vehicles, which represents 16% of industry total repossessions, with related expenses of $411,108. The average ROE and ROA for this category was 38.97% and 30.85%, respectively.

Large Title Pledge Lenders

Title pledge lenders categorized as "large" are companies that have twenty-five (25) or more licensed locations. There are three (3) companies (186 licensed locations) in this category, which represents twenty-nine percent (29%) of the reporting locations. This category entered into 37,957 title pledge agreements during the reporting period, representing 41% of the total agreements made by the industry. Approximately sixty-eight percent (68%) of these agreements were for $500 or less. In regards to interest and fees, the majority of licensed locations in this size category charge the maximum 22% allowed by law. However, one company in this category charged as low as 10% for title pledge agreements. The total net income for this category was $2,721,785 which represents fifteen percent (15%) of the industry total. Of the three (3) companies in this category, one (1) company reported negative net income. This category charged-off 2,044 title pledge agreements, representing 20% of the total charged-off by the industry, with a dollar value of $1,271,239. This category repossessed 4,529 vehicles, which represents 41% of industry total repossessions, with related expenses of $884,848. The average ROE and ROA for this category was 9.31% and 7.07%, respectively.

The following table provides the Return on Equity (ROE) and Return on Assets (ROA) comparison for each group.

	Return on Equity	Return on Assets
	Average	**Average**
Single location (one location)	**14.27%**	**11.12%**
Small (2-9 licensed locations)	**13.24%**	**10.78%**
Medium (10-24 licensed locations)	**38.97%**	**30.85%**
Large (25 or more licensed locations)	**9.31%**	**7.07%**

The average ROE for the title pledge industry was 16.47% and the average ROA was 12.94%. This analysis indicates that a segment of those companies charging the maximum 22% interest and fees allowed by law, reported a negative net income. It also indicates that some companies charging less than the 22% were able to return a profit, even though they were not the most profitable in the industry. Specifically, nine (9) companies representing eighty-one (81) licensed locations were charging less than 22% in interest and fees. Five of the nine companies charging less than 22% interest and fees were profitable, two of which charged between 10% and 15% on title pledge agreements. Four of the nine companies charging less than 22% interest and fees were not profitable, two of which charged between 10% and 17% on title pledge agreements. Overall, the results showed that the companies that were the most profitable were the ones that not only charged the maximum rates, but minimized their expenses better than their peers.

Breakeven Analysis

A breakeven analysis is another financial tool used to determine profitability. Whereas the profitability ratios discussed previously provide a consolidated measure of a company's profitability, the breakeven analysis provides a specific level of price, or interest and fees in this case, at which a company is profitable. A major component of the breakeven analysis is the profit margin. Profit margin illustrates how much of every dollar of gross revenues a company retains in earnings after expenses. The profit margin is calculated by dividing net income by total revenues. For example, total revenues and expenses reported by the title pledge industry as a whole on their financial reports dated June 30, 2006 are noted below.

Revenue	$98,184,527	100.0%
Expenses	$80,341,790	81.8%
Net Income	$17,842,737	18.2% (profit margin ratio)

By dividing net income of $17,842,737 by total revenue of $98,184,527, the profit margin ratio of the title pledge industry was 18.2%. This means that, on average, for each dollar of revenue made, the industry contributed about eighteen cents ($.18) to net income. Eighty two cents ($.82) of every dollar was used to offset business expenses.

Since the breakeven analysis is designed to determine a specific level of interest and fees necessary to be profitable, it is prudent to look only at those title pledge lenders charging 22%, versus a lower amount. It was determined that 197 title pledge companies, representing 564 licensed locations, charged 22% (2% interest/20% service fee) on their title pledge agreements. The following amounts were compiled from the income statements accompanying their financial reports for those companies found to be charging the full 22% permitted by law.

Revenue	$90,010,508	100.0%
Expenses	$71,952,094	79.9%
Net Income	$18,058,414	20.1% (profit margin ratio)

Assuming that all revenue came from title pledge loans then, on average, lenders charging 22% on their agreements reported a profit margin of 20.1% or .201. This means that for every dollar of revenue generated twenty cents ($.20) went to net income. Therefore, on a $100 loan at 22%, lenders earned $22 per month, of which $4.42 ($22 x .201 profit margin ratio) went to net income. Seventeen dollars, fifty-eight cents ($17.58) of the $22 was used to defray costs. The analysis below translates the profit margin into the actual amount of interest and fees that is necessary for the company to breakeven.

				Rate	Break Even Rate
Revenue	$90,010,508	100.0% x 22%	=	22.0%	17.6%
Expenses	$71,952,094	79.9% x 22%	=	17.6%	17.6%
Net Income	$18,058,414	20.1% (profit margin ratio)x 22%	=	4.4%	0%

It appears from this analysis that if the lenders had charged 17.6% instead of 22%, they would have made just enough revenue to offset total expenses without making a profit. As noted above, the break even rate on a title pledge agreement would have been 17.6%. A rate higher than 17.6% would have generated a profit, and anything less would have resulted in a loss.

The following tables give the break even point by company size.

Single Location (141 companies/141 locations)

			Rate	Break Even Rate
Revenue	$19,722,990	100.0% x 22%	= 22.0%	17.3%
Expenses	$15,505,479	78.6% x 22%	= 17.3%	17.3%
Net Income	$ 4,217,511	21.4% (profit margin ratio) x 22%	= 4.7%	0%

The 21.4% profit margin ratio for this category was determined by dividing net income of $4,217,511 by total revenue of $19,722,990. This means that for every dollar of revenue generated about twenty-one ($.21) cents went to net income. On a $100 loan at 22%, lenders earned $22 of which $4.70 ($22 x 21.4% profit margin ratio) went to net income, and $17.30 ($22 x 78.6%) was used to defray costs. If lenders in this group had charged their customers 17.3% instead of 22%, they would have made just enough revenue to offset expenses without making a profit. The break even rate for this category would be 17.3%.

The same formulaic approach and rationale applies to the following categories even though the profit margin of each varies.

"Small"/Companies with 2 – 9 Licensed locations (54 companies/195 locations)

			Rate	Break Even Rate
Revenue	$25,209,750	100.0% x 22%	= 22.0%	18.2%
Expenses	$20,906,048	82.9% x 22%	= 18.2%	18.2%
Net Income	$4,303,702	17.1% (profit margin ratio) x 22%	= 3.8%	0%

"Medium"/Companies with 10 – 24 Licensed locations (Eight companies/123 locations)

			Rate	Break Even Rate
Revenue	$18,808,764	100.0% x 22%	= 22.0%	14.2%
Expenses	$12,117,315	64.4% x 22%	= 14.2%	14.2%
Net Income	$6,691,449	35.6% (profit margin ratio) x 22	= 7.8%	0%

"Large"/Companies with 25 or more Licensed locations (Three companies/186 locations)

			Rate	Break Even Rate
Revenue	$26,269,004	100.0% x 22%	= 22.0%	19.6%
Expenses	$23,423,253	89.2% x 22%	= 19.6%	19.6%
Net Income	$ 2,845,751	10.8% (profit margin ratio) x 22%	= 2.4%	0%

Many lenders engage in multiple lines of business and generate income from other sources. True profitability for each line of business can only be determined by accurately associating costs with a specific segment or business line. The ability to do this depends on how revenue and costs are tracked in various accounting systems.

Although revenue is straightforward, costs are not easily associated with specific segments since operational and administrative functions often support multiple business lines or segments simultaneously. Many costing systems assign shared and indirect costs to business segments using arbitrary cost allocations with broad averages, which usually results in over- and under-costing. For the reasons noted, the Department did a further study on lenders who engage only in title pledge lending, charge 22% on loans, and whose costs to do business are solely title-pledge related. This group of lenders includes sixty-two (62) companies (30% of the total) representing 142 locations.

The following amounts were compiled from the income statements accompanying the licensee's financial reports.

Revenue	$20,957,792	100.0%
Expenses	$17,475,760	83.4%
Net Income	$ 3,482,032	16.6% (profit margin ratio)

On average, these lenders charging 22% on their agreements reported a profit margin of 16.6% or .166. This means that for every dollar of revenue generated about seventeen cents ($.17) went to net income. Therefore, on a $100 loan at 22%, lenders earned $22, of which $3.65 went to net income ($22 x .166 profit margin ratio). Eighteen dollars, thirty-five cents ($18.35) of the $22 was used to defray costs. The analysis below translates the profit margin into the actual amount of interest and fees that is necessary for the company to breakeven:

			Rate	Break Even Rate
Revenue	$20,957,792	100.0% x 22%	= 22.0%	18.4%
Expenses	$17,475,760	83.4% x 22%	= 18.4%	18.4%
Net Income	$ 3,482,032	16.6% (profit margin ratio) x 22%	= 3.6%	0%

It appears from this analysis that if the lenders had charged 18.4% instead of 22%, they would have made just enough revenue to offset total expenses without making a profit. As noted above, the break even rate on a title pledge agreement would have been 18.4%. A rate higher than 18.4% would have generated a profit, and anything less would have resulted in a loss.

The following tables give the break even point by company size.

Single Location (51 companies/51 locations)

			Rate	Break Even Rate
Revenue	$6,695,771	100.0% x 22%	= 22.0%	17.8%
Expenses	$5,421,236	81.0% x 22%	= 17.8%	17.8%
Net Income	$1,274,535	19.0% (profit margin ratio) x 22%	= 4.2%	0%

The 19.0% profit margin ratio for this category was determined by dividing net income of $1,274,535 by total revenue of $6,695,771. This means that for every dollar of revenue generated about nineteen cents (.19) went to net income. On a $100 loan at 22%, lenders earned $22 of which $4.00 ($22 x 19.0% profit margin ratio) went to net income, and $18.00 ($22 x 81.0%) was used to defray costs. If lenders in this group had charged their customers 17.8% instead of 22%, they would have made just enough revenue to offset expenses without making a profit. The break even rate for this category would be 17.8%.

The same formulaic approach and rationale applies to the following categories even though the profit margin of each varies.

"Small"/Companies with 2 – 9 Locations (Nine companies/39 locations)

			Rate	Break Even Rate
Revenue	$3,110,000	100.0% x 22%	= 22.0%	18.7%
Expenses	$2,629,996	85.0% x 22%	= 18.7%	18.7%
Net Income	$ 480,004	15.0% (profit margin ratio) x 22%	= 3.3%	0%

"Medium"/Companies with 10 – 24 Locations (One company/15 locations)

			Rate	Break Even Rate
Revenue	$4,224,277	100% x 22%	= 22.0%	16.9%
Expenses	$3,253,415	77% x 22%	= 16.9%	16.9%
Net Income	$ 970,862	23% (profit margin ratio) x 22%	= 5.1%	0%

"Large"/Companies with 25 or more Locations (One company/37 locations)

			Rate	Break Even Rate
Revenue	$6,927,744	100% x 22%	= 22.0%	19.6%
Expenses	$6,171,113	89% x 22%	= 19.6%	19.6%
Net Income	$ 756,631	11% (profit margin ratio) x 22%	= 2.4%	0%

Conclusion

This report is intended to supplement the February 1, 2006 report which essentially was a baseline report of the title pledge industry before the Department's regulation.

One of the major findings of the 2006 report was that about one out of every four title pledge lenders was charging more than the permitted rates and fees. Department examinations of about 95% of the industry over the last year indicate that this problem appears to have been substantially corrected. Another finding of the 2006 report was that title pledge agreements under prior law were perpetual in nature with no explicit maturity date. Our analysis has shown that the principal reduction requirement mandated by the 2005 amendments will be a key factor in decreasing both the loan term and the interest and fees paid over the life of the loan.

In order for the Department to meet its statutory obligation to address the reasonableness and appropriateness of rates and terms, the main focus of this report is on the financial condition and profitability of the industry.

Title pledge lending is a risk-based business, but risk is an integral part of the business of financial institutions. All financial institutions must determine how to manage that risk. While there is a great profitability diversity on the surface among title pledge lenders, there is a significant segment of the industry that appears to be a model for profitability.

Our research shows that the class of title pledge lenders that operate between 10 and 24 offices should be the starting point of a discussion on profitability. Based on the information collected from the industry, this group's rate of return substantially exceeds its peers. The data on this particular group indicates to us that a lowering of rates could be a consideration that might still permit a segment of the industry to operate depending on the level of rate reduction which is a policy determination rather than a regulatory function. Indeed, there is currently a segment of the industry charging less than the permitted rate.

A lowering of rates will likely cause some companies to go out of business, but we speculate that the current rate provides enough cushion and perhaps incentive for some companies to currently operate at a less than optimum efficiency. A lowering of rates might cause some companies to simply incorporate better risk management controls to compensate for a reduced rate. We cannot speculate whether that would result in a tightening of credit so that this product might become unavailable for certain high risk customers. Whether rates are lowered statutorily or not, there appears to be some competitive market forces in play that might over time reduce rates where competition exists. However, in those areas of the state where there is little or no competition, rates are not as likely to move downward by market pressure.

This report was based on data from the first year of regulation of the title pledge industry. This Department will continue to gather information and issue reports pursuant to our statutory obligations.

NUMBER OF TITLE PLEDGE LENDERS BY COUNTY

# OF TPL LENDERS	COUNTY
90	SHELBY
77	DAVIDSON
40	KNOX
33	HAMILTON
33	RUTHERFORD
19	MADISON
18	SUMNER
17	MAURY
17	SULLIVAN
16	WILSON
13	DICKSON
13	GIBSON
13	PUTNAM
13	WASHINGTON
12	BLOUNT
12	MONTGOMERY
9	COFFEE
9	GREENE
9	MCMINN
9	SEVIER
8	BEDFORD
8	CUMBERLAND
8	HAMBLEN
8	ROBERTSON
7	BRADLEY
7	LAWRENCE
7	OBION
7	TIPTON
7	WARREN
6	CLAIBORNE
6	HENDERSON
6	MARION
5	CAMPBELL
5	CARROLL
5	DYER
5	FRANKLIN
5	HAYWOOD
5	MONROE
5	RHEA
5	ROANE

# OF TPL LENDERS	COUNTY
4	ANDERSON
4	COCKE
4	DEKALB
4	HARDIN
4	LOUDON
4	MACON
4	MARSHALL
4	MCNAIRY
4	SEQUATCHIE
3	CANNON
3	CARTER
3	CHEATHAM
3	CHESTER
3	GILES
3	HARDEMAN
3	HAWKINS
3	HENRY
3	HUMPHREYS
3	JEFFERSON
3	LINCOLN
3	MORGAN
3	OVERTON
3	SCOTT
3	WHITE
3	WILLIAMSON
2	BENTON
2	DECATUR
2	FAYETTE
2	HICKMAN
2	LAUDERDALE
2	LEWIS
2	WEAKLEY
1	FENTRESS
1	HOUSTON
1	JACKSON
1	SMITH
1	STEWART
1	TROUSDALE
1	UNICOI
1	WAYNE

NUMBER OF TITLE PLEDGE LENDERS BY CITY

# OF TPL LENDERS	CITY
82	MEMPHIS
56	NASHVILLE
40	KNOXVILLE
23	CHATTANOOGA
23	MURFREESBORO
19	JACKSON
16	COLUMBIA
13	DICKSON
13	LEBANON
12	CLARKSVILLE
12	COOKEVILLE
11	JOHNSON CITY
10	KINGSPORT
9	ATHENS
9	GREENEVILLE
9	MADISON
8	CROSSVILLE
8	MC MINNVILLE
8	SHELBYVILLE
7	BRISTOL
7	CLEVELAND
7	LAWRENCEBURG
7	MARYVILLE
7	MORRISTOWN
7	SEVIERVILLE
7	SPRINGFIELD
6	HENDERSONVILLE
6	HUMBOLDT
6	LEXINGTON
6	SMYRNA
5	ALCOA
5	BROWNSVILLE
5	DYERSBURG
5	GALLATIN
5	HIXSON
5	MILLINGTON
5	PORTLAND
5	TULLAHOMA
5	UNION CITY
4	ANTIOCH
4	COVINGTON
4	DAYTON
4	DUNLAP
4	HERMITAGE
4	LA VERGNE
4	LAFAYETTE
4	LAFOLLETTE
4	LEWISBURG

# OF TPL LENDERS	CITY
4	MANCHESTER
4	MILAN
4	NEWPORT
4	SAVANNAH
4	SMITHVILLE
3	ASHLAND CITY
3	BOLIVAR
3	ELIZABETHTON
3	FAYETTEVILLE
3	GOODLETTSVILLE
3	HARRIMAN
3	HENDERSON
3	HUNTINGDON
3	JEFFERSON CITY
3	LENOIR CITY
3	LIVINGSTON
3	MOUNT JULIET
3	ONEIDA
3	PARIS
3	PULASKI
3	ROGERSVILLE
3	SELMER
3	SPARTA
3	SWEETWATER
3	TAZEWELL
3	TRENTON
3	WAVERLY
3	WINCHESTER
3	WOODBURY
2	CAMDEN
2	DECHERD
2	EAST RIDGE
2	FRANKLIN
2	HARROGATE
2	HOHENWALD
2	KIMBALL
2	MADISONVILLE
2	MARTIN
2	MC KENZIE
2	OAK RIDGE
2	OLIVER SPRINGS
2	PARSONS
2	RIPLEY
2	SODDY DAISY
2	SOUTH FULTON
2	SOUTH PITTSBURG
2	WHITWELL
1	ADAMSVILLE

# OF TPL LENDERS	CITY
1	ATOKA
1	CARTHAGE
1	CARYVILLE
1	CENTERVILLE
1	CLINTON
1	COLLIERVILLE
1	DOVER
1	ERIN
1	ERWIN
1	FAIRVIEW
1	GAINESBORO
1	GRAY
1	HARTSVILLE
1	HICKORY HILL
1	JAMESTOWN
1	JONESBOROUGH
1	KINGSTON
1	LAKE CITY
1	LAKELAND
1	LOUDON
1	LYLES
1	MASON
1	MONTEREY
1	MOUNT PLEASANT
1	MUNFORD
1	NEW TAZEWELL
1	OAKLAND
1	OLD HICKORY
1	PIGEON FORGE
1	RED BANK
1	ROCKWOOD
1	SEYMOUR
1	SOMERVILLE
1	SPRING CITY
1	TALBOTT
1	WARTBURG
1	WAYNESBORO
1	WESTMORELAND
1	WHITE HOUSE